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Report of the Management Coordination Committee on the assessment of progress in UNOPS*

Summary

This report is submitted to the Executive Board in response to its decision 2004/36 requesting the Management Coordination Committee (MCC) assessment of progress by the United Nations Office of Project Services (UNOPS) and guidance provided to UNOPS.

MCC notes that in 2004, UNOPS business acquisition for delivery in 2004 and 2005 is encouraging. However, the MCC also notes that UNOPS will complete 2004 with revenues falling below January 2004 projections, and expresses concern as to whether the projected level of revenue for 2005 will materialize.

The MCC reiterates the underlying principle of UNOPS business, which requires that expenditure be below the income at any single year.

Against this background, the MCC endorses the 2005 budget proposal, provided that UNOPS the expenditures remain below 95 per cent of actual income.

Elements of a decision

The Executive Board may wish to:

(a) Request UNOPS senior management to outline a plan of action to improve the financial performance of UNOPS taking into account the options proposed by the MCC, including relocation and possible merger or integration of all or some of present UNOPS functions with another United Nations organization; and

(b) Invite donor countries to consider a possible package of assistance to UNOPS relocation, including rent-free facilities, subsidized utilities, and other recurrent costs of accommodation and relocation costs.

* The compilation of data required to provide the Executive Board with the most current information has delayed the submission of the present report.

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I. Background

1. The Executive Board, at its September 2004 session, requested the MCC to report to the Executive Board at the January 2005 session on its assessment of progress in UNOPS and to provide appropriate guidance to UNOPS. In this paper the MCC provides (a) its views on the report of the Executive Director on the activities of UNOPS in 2004; (b) the plan and budget proposals for 2005; and (c) recommendations for the future operation of UNOPS.

II. 2004 preliminary results

2. Preliminary results of UNOPS implementation of the 2004 budget are reflected in the Executive Director's report to the Executive Board (DP/2005/9), which states that UNOPS will complete 2004 with revenues falling below January 2004 projections. Indeed, UNOPS is likely to conclude 2004 with a projected ending fund balance of about $9 million, including $6 million held in the operating reserve.

3. The MCC is concerned that the restructuring exercise that UNOPS embarked on in 2004 proved somewhat disruptive to the delivery of UNOPS project portfolios, and senior management was requested by MCC to contain general and other operating costs to ensure that the overall fund balance of UNOPS would not be drawn down further.

4. The MCC notes that in 2004, UNOPS business acquisition for delivery in 2004 and 2005 is encouraging. At 30 November 2004, cumulative project portfolio acquisitions for the year stood at $663 million. In 2004 UNOPS acquired 51 per cent of its new business from international financial institutions and 12 per cent of its new business from United Nations organizations other than UNDP.

5. The MCC has urged the management of UNOPS to ensure that new business is increasingly of the type that generates higher income, with an emphasis on project-management activities rather than limited loan-servicing activities. UNDP core accounted for 13 per cent of new business, UNDP Trust Fund accounted for 15 per cent and UNDP management services agreements accounted for 9 per cent. New business acquired in 2004 is primarily in emergency and post-conflict or transition activities; while development-related activities account for 29 per cent of newly acquired UNOPS business. This represents a shift in the nature of UNOPS operations towards emergency and post conflict situations and countries.

III. 2005 budget proposals and implications

6. Estimated total revenue for 2005 is $53.77 million, which is composed of: (a) revenue from project portfolio implementation services at $42.14 million, and (b) service revenue of $9.82 million for provision of supervision and loan administration services to International Fund for Agricultural Development and from the Global Fund to combat AIDS, Tuberculosis and Malaria; and rental income from subleasing UNOPS headquarters premises, interest income and other miscellaneous income totalling $1.81 million.

7. 2005 expenditures have been estimated at $50.86 million: (a) salaries and benefits: $28.0 million, and (b) general and administrative costs: $10.05 million.

Salaries and benefits will increase by $1.84 million over 2004 estimates, taking into consideration expected increases in post adjustment and some additional staff to handle higher levels of delivery. The MCC notes that UNOPS plans to reduce ongoing general and administrative expenditures by $2 million in comparison to 2004. Change management activities for 2005 are estimated at $4.7 million.

8. Based on the revenue and expenditure projections indicated above, the UNOPS budget proposal for 2005 foresees a year-end fund balance of about $12.million, which is $3 million more than the projected fund balance for 2004.

9. The MCC has serious doubts as to whether the projected level of revenue for 2005, which foresees an increase of 40 per cent over 2004 projections, will materialize. Projections of revenues in the recent past have not been accurate and reliable.

10. The MCC also notes that the 2005 budget proposal offers only a narrow operating surplus of $2.9 million, and that the level of the 2005 fund balance is highly dependent on the final 2004 fund balance results as well as on UNOPS ensuring that the 2005 income and expenditure levels are as projected.

11. The MCC observes that historically – and most recently in 2004 – UNOPS has not demonstrated its ability to control expenditures to within budgeted levels, nor has it been able to achieve the projected revenue. Therefore, the MCC urges utmost caution in the implementation of the 2005 budget proposal, in which UNOPS plans to contain ongoing operating expenditures without carrying out any major restructuring in 2005.

12. The MCC reiterates the underlying principle of UNOPS business, which requires that expenditure be below the income at any single year. The MCC is extremely concerned that UNOPS may again incur an operating loss in 2005, and urges UNOPS senior management to monitor revenue and expenditures on a continuous basis and to take all measures within its power to ensure adherence to the above principle.

13. The Executive Director has assured the MCC that he will constantly monitor income and expenditure levels throughout 2005, provide regular feed back to the MCC and make appropriate adjustments to expenditure levels if necessary, thus ensuring that the projected fund balance at end of 2005 is not further eroded.

14. The Executive Director is also committed to implementing fully the recommendations of the Board of Auditors and to preparing the financial statements for 2004/2005 in compliance with the recommendations of the Board of Auditors.

IV. Conclusions

15. The MCC recognizes that UNOPS has made progress in implementing some important aspects of the UNOPS change management programme – for example, the decentralization of the project portfolio management responsibility to regional offices. Furthermore, UNOPS has significantly increased its business acquisition and has made a shift in the composition of its portfolio. This clearly demonstrates that there is a demand for the particular type of project management services that UNOPS offers, especially to international financial institutions.

16. Nevertheless, the MCC notes that a number of important change initiatives remain to be implemented, in particular the completion of a corporate strategy for achieving financial viability. The MCC expects that in developing this strategy, UNOPS will find solutions that will rectify the fundamental structural imbalance in the operations that lead to high fixed costs, over-expenditure against earnings, and gradual erosion in the level of the year-end fund balance. Without prejudice to the valuable contribution made by UNOPS to the work of the United Nations system, if these trends were to continue they would seriously compromise the future viability of UNOPS.

17. In his annual report to the Executive Board at the June 2004 session, the Executive Director indicated that another review of service locations and ongoing operating expenditures would be conducted in the context of the work on the UNOPS corporate strategy. The MCC understands that it would not be possible to implement further major restructuring in 2005 because UNOPS preferred to concentrate all efforts on meeting planned delivery and income targets, bearing in mind the challenge posed by the high volume of business to be delivered in 2005 in comparison to 2004.

18. Nevertheless, it is essential that UNOPS senior management provide reassurance to the Executive Board by spelling out a coherent and consistent approach to dealing with these critical problems within a specified time frame.

19. The MCC discussed with the UNOPS senior management various approaches that could be employed to improve UNOPS financial performance in the long term. UNOPS may be able to survive in the medium term if it operates in a market segment where net margins are sufficient to cover the cost of on-going operations, necessary investments in business development and continuous improvement in business processes. In order to do this UNOPS must also change its existing operating modalities to focus on larger projects that have shorter implementation time frames and that utilize short-term expertise or "as needed" sub-contractors.

20. The MCC also discussed with UNOPS senior management options to help ensure UNOPS sustainability:

Option 1. UNOPS would continue operations as a separate entity, but with a reduced cost base achieved through consolidation of functions and/or relocation of headquarters corporate functions to a lower-cost duty station; with a possible package of assistance from donors that may include rent-free facilities, subsidized utilities, other recurrent costs of accommodation and relocation costs.

Option 2. Merger/integration of the existing operation or key elements thereof with another United Nations organization, while maintaining the separate identity and brand name of UNOPS (this option may also include relocation of the headquarters corporate and/or other functions to a lower-cost duty station).

21. In summary, in further developing the corporate strategy for future viability, UNOPS should seek to build on the high-value elements of the existing operation, such as its unique project management services, which are recognized for their speed and flexibility. On the other hand, UNOPS should identify and eliminate the low-value-added aspects of the UNOPS operation in order to achieve improved financial performance.

V. Recommendations

22. Against this backdrop, the MCC endorses with caution the 2005 budget proposal, provided that 2005 is viewed as a 'survival year', during which UNOPS will consolidate the gains made in the implementation of all aspects of the change management programme already implemented, at the same time ensuring that the expenditures remain below 95 per cent of actual income. In the course of 2005, UNOPS will move expeditiously to develop a plan of action to correct the persistent pattern of income volatility and high fixed costs, in order to become financially viable in 2006. MCC intends to monitor closely revenue and expenditures throughout the year.

23. The MCC recommends that the Executive Board request UNOPS to outline, in the context of the ongoing exercise to develop a corporate strategy, a plan of action to improve financial performance by realigning and reconfiguring its operations during the period 2006-2007. The plan of action should be based on a comparative analysis of the cost effectiveness of different options for the configuration of future operations that may involve:

(a) Continued operations as a separate entity, but with a reduced cost base, achieved through consolidation of functions and/or relocation of headquarters corporate functions to a lower-cost duty station; or

(b) Merger/integration of the existing operation or key elements of it with another UN agency, while maintaining the separate identity and brand-name of UNOPS; this option may also include relocation of the Headquarters corporate and/or other functions to a lower cost duty station.

(c) Donor countries are invited to consider a possible package of assistance to UNOPS that may include rent-free facilities, subsidized utilities, other recurrent costs of accommodation and relocation costs.

24. UNOPS should submit a full plan of action for decision by the Executive Board at its annual session 2005, subsequent to review by the MCC.